

ORIGINAL

DIVISION OF CONSUMER ADVOCACY
Department of Commerce and
Consumer Affairs
335 Merchant Street, Room 326
Honolulu, Hawaii 96813
Telephone: (808) 586-2800

FILED
2009 MAR 30 P 3:29
PUBLIC UTILITIES
COMMISSION

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding to Investigate)
Implementing a Decoupling Mechanism for)
Hawaiian Electric Company, Inc., Hawaii)
Electric Light Company, Inc., and Maui)
Electric Company, Limited.)

DOCKET NO. 2008-0274

DIVISION OF CONSUMER ADVOCACY'S
RESPONSES TO PUBLIC UTILITIES COMMISSION'S INFORMATION REQUESTS

Pursuant to Commission's letter, dated March 5, 2009, the Division of Consumer Advocacy submits its **RESPONSES TO PUBLIC UTILITIES COMMISSION'S INFORMATION REQUESTS PREPARED BY THE NATIONAL REGULATORY RESEARCH INSTITUTE** in the above docketed matter.

DATED: Honolulu, Hawaii, March 30, 2009.

Respectfully submitted,

By Catherine P. Awakuni
CATHERINE P. AWAKUNI
Executive Director

DIVISION OF CONSUMER ADVOCACY

DOCKET NO. 2008-0274

PUBLIC UTILITIES COMMISSION

**DIVISION OF CONSUMER ADVOCACY'S RESPONSES TO
PUBLIC UTILITIES COMMISSION'S INFORMATION REQUESTS**

24. At the technical workshop, the participants discussed that the proposed decoupling adjustment would create a bias for the utility to overstate test year sales and for rate increase opponents to understate test year sales. Please discuss.

RESPONSE: It is not entirely clear what discussion of "bias" is being referenced.

In general, the parties to any traditional rate case proceeding have an interest in carefully reviewing all elements of the revenue requirement so that consumer or shareholder interests are not disadvantaged by any bias in estimation of the rate case values. This is because rate case amounts such as test year sales levels, labor costs, fuel costs, etc. all become "fixed" in the test year and if actual amounts in later periods are higher or lower, the difference has a direct impact upon utility earnings.

In contrast, when an element of the revenue requirement equation is to be "tracked" through a rate adjustment mechanism such as decoupling, there is a lessened emphasis upon precise quantification of that element in rate cases. For example, with the Energy Cost Adjustment Clause ("ECAC") in place, precise quantification of fuel prices in rate cases is not essential because any inaccuracies will be corrected through the ECAC. However, even with this "backstop", efforts are still made to present

reasonable estimates to be used in setting base rates and as the benchmark in rate adjustment mechanisms to avoid customers facing large adjustments, either upwards or downwards, through those mechanisms. Absent any ECAC, it would be essential that fuel prices and costs be accurately specified in rate cases which would be extremely difficult given recent fuel price volatility.

The Consumer Advocate believes that adoption of full decoupling, where a revenue balancing account ("RBA") is used to track all of the difference between actual versus rate case margin revenues, tends to remove any bias for over or under-statement of test year sales volumes and margin revenues. There should now be no bias in rate cases regarding quantification of test years sales because all subsequent changes in KWH sales and margin revenues from the test year levels are fully tracked through decoupling. This explains why HECO is indifferent regarding adoption of its revised lower sales projections in the test year updates explained by witnesses T-1 and T-2. Decoupling introduces a sense of indifference to sales levels that are used for ratemaking within a broad range of reasonableness. However, other less direct revenue requirement impacts arising from sales estimates, such as uncollectible expenses, working cash and energy heat rates, cause adoption of reasonable sales forecasts to still be important in rate cases.

Under traditional test year ratemaking without decoupling, the utility is rewarded financially whenever actual sales volumes exceed levels used for ratemaking and vice versa. Historically, when KWH sales were persistently growing between test years, the sales growth after the test year created additional margin revenues that could be used to either pay increasing costs or expand earnings. Now that these trends have reversed and KWH usage is declining, adoption of decoupling will insulate the utility and its shareholders from the financial losses that would otherwise result from declining sales between test years.

25. Sales decoupling, the RAM and REIS as proposed, each either reduce total risk or shift the risk of a utility not achieving the authorized rate of return to customers. Given the changes in risk associated with these revenue adjustment mechanisms please explain:
- a. Why should the utility be allowed to retain any earnings in excess of the authorized rate of return rather than these earnings in excess of the authorized level being allocated to the benefit of customers? Please suggest a mechanism that could allocate these earnings to customers?

RESPONSE: Decoupling and RAM will produce significant shifts in risk from shareholders to ratepayers that must be recognized in determining allowed rates of return. A corresponding downward adjustment in allowed returns should be ordered by the PUC to recognize these changes in risks borne by HECO. This does not mean, however, that the utility has become fully insulated from all risks and opportunities. In fact, utility management still must control costs between test years and still faces a regulatory lag opportunity to grow achieved earnings if costs can be successfully managed. For example, if the adopted RAM formula increases revenues to account for an estimated inflation rate, net of productivity, of 2 percent but management is able to contain cost growth (expenses plus return on rate base) to only 1 percent, earnings can be expected to increase. This is precisely why the Consumer Advocate has proposed an earnings sharing grid – to encourage and reward management of costs by allowing a “share” of any resulting higher earnings to be shared between shareholders and

ratepayers. If all earnings in excess of authorized levels are required to be returned to ratepayers, management has no incentive to control costs beyond the threat of regulatory prudence disallowance.

- b. Please discuss the effect the reduction and shift in risk should have on the utilities' authorized rate of return.

RESPONSE: The Consumer Advocate agrees that the proposed decoupling and RAM will reduce and shift risk from the utilities' shareholders to the customers. Depending on the final terms of the decoupling mechanism that is authorized by the Commission, the reduction and shift of risk as it relates to variations in sales volumes will vary (see response to part (a) above that discusses other risks that utilities would continue to face).

As a result, the Consumer Advocate is unable to quantify a specific value or range at this time beyond that which was already offered in the responses filed on February 20, 2009 responding to the National Regulatory Research Institute's Scoping Paper Appendix 2 questions. At that time, the Consumer Advocate offered that a preliminary estimate that could be used as a placeholder was 25 basis points.

As already noted, the Consumer Advocate contends that other issues must also be considered, including but not limited to the nature and terms of the decoupling mechanism authorized by

the Commission. Furthermore, the Consumer Advocate asserts that the appropriate time to estimate the effects will follow the Commission's decision on the nature and terms of the decoupling and RAM mechanism as well as the appropriate consideration of other factors, both internal and external to the utility companies, in the determination of the rate of return.

26. Please compare the regulatory costs associated with the proposed RAM and rate cases every two years.

RESPONSE: The RAM and decoupling proposals being advanced by the HECO Companies and the Consumer Advocate do not produce any savings in regulatory costs, relative to recent patterns of rate cases every few years, unless it is assumed that more frequent rate cases would occur in the absence of RAM and decoupling. No parties have waived their rights to file traditional rate case applications whenever needed upon implementation of decoupling and RAM, but the Consumer Advocate is optimistic that these measures may be successful in spreading out rate cases on a more predictable pattern as set forth in the proposals of HECO and the Consumer Advocate submitted on January 30 in this Docket. Should HECO decide to file more frequently than scheduled rate cases, the Commission may find RAM to be ineffective and discontinue it at any time.

Decoupling and RAM will introduce additional filings and regulatory costs to be borne by HECO, the Commission, the Consumer Advocate and other parties. The annual decoupling/RAM filings should be rigorously analyzed by the Consumer Advocate and the PUC Staff, leading to an increase in overall regulatory activities and costs because these filings are incremental to the existing levels of activity before the Commission.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S RESPONSES TO PUBLIC UTILITIES COMMISSION'S INFORMATION REQUESTS PREPARED BY THE NATIONAL REGULATORY RESEARCH INSTITUTE** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

DEAN MATSUURA
MANAGER
REGULATORY AFFAIRS
HAWAIIAN ELECTRIC COMPANY, INC.
HAWAII ELECTRIC LIGHT COMPANY, INC.
MAUI ELECTRIC COMPANY, LTD.
P.O. Box 2750
Honolulu, HI 96840-0001

1 copy
by hand delivery

JAY IGNACIO
PRESIDENT
HAWAII ELECTRIC LIGHT COMPANY, INC.
P. O. Box 1027
Hilo, HI 96721-1027

1 copy
by U.S. Mail

EDWARD L. REINHARDT
PRESIDENT
MAUI ELECTRIC COMPANY, LTD.
P. O. Box 398
Kahului, HI 96732

1 copy
by U.S. Mail

THOMAS W. WILLIAMS, JR., ESQ.
PETER Y. KIKUTA, ESQ.
DAMON L. SCHMIDT, ESQ.
GOODSILL, ANDERSON QUINN & STIFEL
Alii Place, Suite 1800
1099 Alakea Street
Honolulu, Hawaii 96813

1 copy
by hand delivery

Counsel for HECO, HELCO, and MECO

RANDALL J. HEE, P.E.
PRESIDENT AND CEO
KAUAI ISLAND UTILITY COOPERATIVE
4463 Pahe'e Street, Suite 1
Lihue, Hawaii 96766-2000

1 copy
by U.S. Mail

TIMOTHY BLUME
MICHAEL YAMANE
KAUAI ISLAND UTILITY COOPERATIVE
4463 Pahe'e Street, Suite 1
Lihue, Hawaii 96766-2000

1 copy
by U.S. Mail

KENT D. MORIHARA, ESQ.
KRIS N. NAKAGAWA, ESQ.
RHONDA L. CHING, ESQ.
MORIHARA LAU & FONG LLP
841 Bishop Street, Suite 400
Honolulu, Hawaii 96813

1 copy
by hand delivery

Counsel for KIUC

DEBORAH DAY EMERSON, ESQ.
GREGG J. KINKLEY, ESQ.
DEPUTY ATTORNEY GENERAL
DEPARTMENT OF THE ATTORNEY GENERAL
STATE OF HAWAII
425 Queen Street
Honolulu, Hawaii 96813

1 copy
by hand delivery

Counsel for DBEDT

MR. CARL FREEDMAN
HAIKU DESIGN & ANALYSIS
4234 Hana Highway
Haiku, Hawaii 96708

1 copy
by U.S. Mail

MR. WARREN S. BOLLMEIER II
PRESIDENT
HAWAII RENEWABLE ENERGY ALLIANCE
46-040 Konane Place, #3816
Kaneohe, Hawaii 96744

1 copy
by U.S. Mail

DOUGLAS A. CODIGA, ESQ.
SCHLACK ITO LOCKWOOD PIPER & ELKIND
TOPA FINANCIAL CENTER
745 Fort Street, Suite 1500
Honolulu, Hawaii 96813

1 copy
by U.S. Mail

Counsel for Blue Planet Foundation

MR. MARK DUDA
PRESIDENT
HAWAII SOLAR ENERGY ASSOCIATION
P.O. Box 37070
Honolulu, Hawaii 96837

1 copy
by U.S. Mail

MIKE GRESHAM
HAWAII HOLDINGS, LLC
dba FIRST WIND HAWAII
33 Lono Avenue, Suite 380
Kahului, Hawaii 96732

1 copy
by U.S. Mail

GERALD A. SUMIDA, ESQ.
TIM LUI-KWAN, ESQ.
NATHAN C. NELSON, ESQ.
CARLSMITH BALL LLP
ASB Tower, Suite 2200
1001 Bishop Street
Honolulu, Hawaii 96813

1 copy
by U.S. Mail

Counsel for Hawaii Holdings, LLC, dba First Wind Hawaii

DATED: Honolulu, Hawaii, March 30, 2009.

A handwritten signature in cursive script, reading "Joshua Gludis", is written over a horizontal line.